Economic Outlook

Irving Trust

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The unknowns for the economy this year have to do more with degree than with direction. It is generally expected that the real merchandise trade deficit will shrink, while auto sales and commercial construction activity will slacken. Forecasts of real economic growth differ as to whether the improvement in trade will be substantial enough to offset weakness in other areas. Recent economic reports continue to indicate that the decline in the dollar against major currencies is indeed beginning to restore the competitiveness of many U.S. manufacturing industries. With interest rates likely to remain relatively low this year, the economy is expected to show moderate growth, with continued expansion at least through 1988. Real GNP is expected to rise 3.5% from the fourth quarter of 1986 to the fourth quarter of 1987, compared to an estimated 2.7% rise in 1986.

Much concern has been expressed regarding the possible negative effects of tax reform on capital spending. In addition, the high office vacancy rates in many parts of the country would indicate a falloff in new projects regardless of tax reform. Several aspects of tax reform, however, make investment in real estate much less attractive than was the case before 1987. As a result, it is not surprising that office construction expenditures fell 14.4% from November 1985 to November 1986. This weakness is likely to continue in 1987. Despite the loss of the investment tax credit, continued strong competition from imports makes it imperative for firms to invest in the best equipment available if they are to compete against foreign producers with significantly lower labor costs. As a result, real business capital spending is expected to remain unchanged this year, after declining an estimated 0.8% in 1986.

Housing starts declined during the course of 1986, but single-family starts may yet show improvement this spring. Total starts fell from 2 million units in the first quarter of 1986 to 1.6 million in November. The drop was particularly steep for multi-family housing, which is especially affected by tax reform. Mortgage rates have continued to edge downward, however, after rising during mid-1986. In December, the contract rate on fixed-rate mortgages averaged 9.3%, even lower than last spring. The housing market seemed to run ahead of itself early last year, with starts and prices racing ahead of what the market could absorb. With lower mortgage rates, more settled market conditions, and continued favorable demographic factors, it seems likely that the number of single-family starts will rise in the first half of this year, though starts may weaken once again during the second half. Housing starts are expected to total 1.65 million units this year, compared to an estimated 1.82 million in 1986 and 1.74 million in 1985.

The slowdown in inflation last year was astounding. As of November, the consumer price index was only 1.3% higher than a year ago. Of course, this result is a reflection of the decline in oil prices. Excluding energy, consumer prices rose 3.9%. With crude oil now selling at $19 a barrel, some upward pressure on gasoline prices is likely to be evident in coming months. Without the benefit of sharply declining oil prices, consumer prices are expected to rise 4.5%-5% from December 1986 to December 1987.

Bernard Schoenfeld

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Economic Forecast

Percent Changes at Annual Rates

	Actual				Forecast				Actual	Forecast	
				1986				1987	1984-	1985-	1986-
	I	II	III	IV	I	II	III	IV	1985	1986	1987
Gross National Product	6.2	2.6	6.4	7.3	6.9	8.5	8.0	7.4	6.2	5.6	7.2
Real GNP	3.8	0.6	2.8	3.8	3.3	4.1	3.8	2.7	2.7	2.7	3.3
GNP Price Deflator	2.5	1.8	3.7	3.4	3.6	4.2	4.1	4.5	3.3	2.8	3.7

	Actual	Forecast	Actual	Forecast	
	1986: III	1986: IV	1984-1985	1985-1986	1986-1987
Consumer Spending	10.3%	4.7%	7.1%	6.3%	6.9%
Durable Goods	51.0	-9.7	8.5	8.1	5.3
Nondurable Goods	1.9	7.4	4.0	3.3	6.7
Services	6.5	7.4	8.9	7.9	7.5
Business Capital Spending	1.3	10.0	10.0	0.7	3.3
Structures	-5.5	8.3	11.1	-6.7	-1.2
Equipment	4.5	10.8	9.4	4.5	5.4
Residential Investment	11.6	8.4	5.7	13.1	7.8
			1985	1986	1987
Change in Inventories	$-4.5b.	$13.5b.	$11.1b.	$16.8b.	$22.1b.
Net Exports of Goods and Services	$-108.9b.	$-114.7b.	$-78.9b.	$-105.5b.	$-93.3b.
			1984	1985-1986	1986-1987
Government Purchases	6.3%	7.2%	11.2%	6.1%	7.1%
Federal	1.9	7.0	13.7	3.7	6.5
Defense	12.6	7.0	10.4	8.3	7.9
Other	-26.5	6.4	24.3	-8.9	1.8
State & Local	9.6	7.4	9.3	7.9	7.5
Corporate Profits Before Tax	4.9*	4.9*	-5.3	5.1	9.9
Corporate Profits After Tax	1.9*	0.2*	-6.3	1.1	9.6
Plant and Equipment Expenditures	-0.4	5.3	9.2	-1.7	2.0
Real Final Sales#	4.5	2.7	4.2	2.5	3.3
Real Disposable Personal Income	-3.0	-1.2	2.3	3.0	3.3

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1984-1985	1985-1986	1986-1987
Consumer Price Index**	3.6%	2.4%	3.6%	3.7%	1.4%	4.7%
Producer Price Index for Finished Goods**	6.0	3.6	2.4	2.1	-2.5	3.9
Industrial Production	0.0	0.1	0.6	2.2	1.0	2.3
Retail Sales##	5.6	-5.2	0.5	6.4	5.1	5.2
				1985	1986	1987
Auto Sales (millions of units, a.r.)	16.1	10.3	10.5	11.1	11.6	10.6
Housing Starts (millions of units, a.r.)	1.66	1.63	1.60	1.74	1.82	1.65
Unemployment Rate	7.0%	6.9%	6.9%	7.2%	7.0%	6.4%
Merchandise Trade Deficit (a.r.)	$150.7b.	$144.7b.	$230.7b.	$148.5b.	$174.0b.	$155.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
$b. = billions a.r. = annual rate F = Forecast

*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).

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